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Report to the President and Chief Executive Officer, Resolution Trust Corporation

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RESOLUTION TRUST CORPORATION

Oversight of Certain Loan Servicers Needs Improvement

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The Honorable Albert V. Casey
President and Chief Executive Officer
Resolution Trust Corporation

Dear Mr. Casey:

Under agreements entered into by failed thrifts, the Resolution Trust Corporation (RTC) relies on thousands of commercial banks, thrifts, and mortgage companies to help service its inventory of mortgages and loans. In December 1991, these institutions—known as inherited third-party servicers—serviced over 300,000 mortgages and loans, which is over 33 percent of RTC's total inventory of mortgages and loans held by thrifts in receivership. Among other things, these servicers are to collect and remit to RTC millions of dollars in principal and interest payments every month. This report assesses RTC's oversight of these inherited loan servicers and the adequacy of RTC's policies and procedures for monitoring their loan collection activities.

Results in Brief

RTC does not adequately oversee its inherited loan servicers, who service approximately $7.5 billion in mortgages and loans for RTC. It does not have the necessary policies and procedures in place to monitor the inherited servicers' loan collection activities. Consequently, RTC cannot ensure that servicers are accurately accounting for and remitting loan payments. In addition, RTC does not know if its servicers are sound financial institutions capable of maintaining the value and marketability of RTC's mortgages and loans. We believe that some of the servicers do not meet reasonable loan servicing standards. For example, in September 1991, 84 of 298 institutions servicing loans for RTC's receiverships in Florida were considered ineligible by the Federal National Mortgage Association (Fannie Mae) to service its mortgages. Furthermore, RTC does not have an accurate inventory of its inherited loan servicers.

Although RTC is planning to address these issues, its progress has been slow. Given the number of assets and the amount of money involved, RTC needs to improve its oversight of inherited servicers to protect the value of mortgages and loans under their control. Without closer oversight, RTC may not obtain full recovery from collections and sales of these mortgages and loans.

Background

Thrifts, as well as other financial institutions, are involved in many aspects of real estate lending and mortgage finance, including originating, holding, and servicing loans. Loan originators receive fees for making loans; investors hold loans as assets and earn income from monthly principal and interest payments; and loan servicers receive fees for collecting payments due from borrowers.

Loans and the rights to service loans both are marketable assets that can be bought and sold together, or traded separately. Thrifts and other financial institutions may invest in loans without having to originate or service them. For example, investors who want income from principal and interest payments without loan servicing responsibilities can acquire loans without the servicing rights and rely on third-party servicers to collect monthly payments from borrowers.

Besides holding and servicing their own loans, many thrifts acquired loans whose servicing rights were retained by other institutions. RTC, as receiver for failed thrifts, assumes responsibility for the loan servicing agreements between the failed thrifts and other institutions. As a result, RTC must rely on thousands of financial institutions—including banks, other thrifts, and mortgage companies—to service its loans and account for and remit payments from borrowers. As of December 1991, these inherited servicers were servicing over 300,000 RTC mortgages and loans with a book value of $7.5 billion—over 33 percent of the mortgages and loans held by RTC's receiverships and about 14 percent of their book value.

RTC's inherited servicers collect and account for loan payments from borrowers and send the payments, minus their servicing fees, to RTC. The servicers also keep the escrow accounts for real estate taxes and hazard insurance and, in some cases, take foreclosure actions on defaulted loans.

Besides the inherited servicers, RTC contracts directly with thrift acquirers, loan servicing companies, and asset management companies for loan servicing. Loan servicing is also done by RTC field office staff. Although RTC has policies and procedures for evaluating the financial condition and performance of its loan servicing contractors, it has not set up similar policies and procedures to oversee its inherited loan servicers. Table 1 shows the number and value of loans under the various arrangements RTC's receiverships use for loan servicing.

Table 1: RTC's Receivership Loan Servicing Arrangements as of December 1991

Dollars in billions

Loan servicers	Number of loans[a]	Value	Percent Loans	Percent Value
Inherited servicers	301,616	$7.5	33.5	14.2
Loan servicing contractors	221,133	14.0	24.6	26.4
RTC field office staff	201,300	13.4	22.4	25.1
Thrift acquirers	164,996	12.1	18.3	22.8
Assets management contractors	10,522	6.1	1.2	11.5
Total	**899,567**	**$53.1**	**100.0**	**100.0**

[a]Includes mortgage loans and other loans.

Objective, Scope, and Methodology

We analyzed data compiled by RTC to determine the number and value of mortgages and loans serviced by inherited loan servicers. We reviewed policies and procedures issued by RTC headquarters and visited RTC's four regional offices and consolidated field offices in Atlanta; Dallas; Denver; Kansas City, Mo.; Tampa; and King of Prussia, Pa., to review and document field office policies and procedures for oversight of inherited servicers. To assess RTC's controls over the inherited servicers' loan collections, we reviewed information the servicers reported to RTC and interviewed RTC staff responsible for receivership asset operations at the six consolidated offices we visited. We did not visit servicers or review the servicers' internal control procedures. In addition, we did not obtain information or data from those thrifts that were in conservatorship at the time of our review.

To assess the acceptability of RTC's inherited servicers, we relied on mortgage servicing criteria developed by Fannie Mae. These criteria are generally accepted by financial institutions involved in mortgage finance. We reviewed Fannie Mae's mortgage servicing guidelines and discussed servicer eligibility requirements with Fannie Mae officials. Because RTC did not have a complete nationwide list of inherited servicers, we obtained a list of servicers for RTC's 31 Florida receiverships, which was compiled by RTC's Tampa Consolidated Field Office, to determine their status under Fannie Mae's servicer requirements.

We did our work from April through November 1991 in accordance with generally accepted government auditing standards.

RTC Does Not Adequately Oversee Inherited Loan Servicers

Although inherited servicers handle $7.5 billion of mortgages and loans for RTC, RTC does not audit their loan collection records or evaluate the institutions' financial condition and ability to do acceptable loan servicing work. Also, RTC lacks information needed to effectively oversee the servicers.

Inherited Servicers Handle a Significant Amount of RTC's Mortgages and Loans

From August 1989, its inception, through December 1991 RTC has recovered about $110 billion from sales and collections of mortgages and loans held by failed thrifts. As of December 1991, RTC's receiverships still held $7.5 billion in mortgages and loans serviced by inherited servicers. RTC will likely inherit additional loans serviced by this type of servicer as more failed thrifts are resolved. Table 2 shows that the number and value of loans under the control of inherited servicers increased overall for the quarters ended in March, June, September, and December 1991.

Table 2: Receivership Mortgages and Loans Handled by Inherited Servicers for the Quarters Ended March to December 1991

Dollars in billions

Quarter	Number of loans[a]	Value
March	223,723	$5.1
June	213,076	6.1
September	267,316	7.8
December	301,616	7.5

Note: RTC did not compile data on loan servicers for all of its receiverships before March 1991.

[a]Includes mortgage loans and other loans.

RTC Is Not Auditing Inherited Loan Servicers

RTC does not require its field offices to audit the inherited servicers' internal loan collection records to verify the accuracy of their loan status reports. Instead, RTC relies solely on the servicers to keep accounting records that accurately reflect what debtors have paid and what loan balance remains.

In July 1991, RTC distributed to its field offices an Asset Operations Manual that contains general policies and guidelines for managing and servicing receivership assets. The manual established RTC's only written policies for managing loan assets serviced by inherited servicers. Essentially, it requires field office staff to record and track loan balances reported by the servicers until the loans can be sold or transferred to another servicer. Although the manual includes procedures for field office staff to reconcile loan collections with loan balances reported by the servicers, it does not

require RTC staff to audit the servicers' internal accounting records. Consequently, RTC has not verified the accuracy of the servicers' information.

Although the consolidated field offices we visited do review the servicers' loan status reports, RTC officials said they generally accept that the servicers are reporting all of their collections accurately and applying principal and interest payments to the loans in a timely manner. They do not review servicers' internal records and compare them with the servicers' reports to RTC.

RTC Does Not Evaluate the Financial Condition and Performance of Inherited Servicers

RTC does not have a system in place to evaluate inherited servicers' financial condition and operating performance. Information about the servicers' financial condition is important to ensure they have the resources and capability to service loans. Similarly, RTC needs information about the servicers' operating performance because if the loans are not serviced properly, their value and marketability could deteriorate.

Mortgage investors rely on servicers to remit on time all funds collected from borrowers and to protect the value of the mortgage collateral by paying property taxes and maintaining adequate hazard insurance. If servicers are not adequately performing these functions, the market value of the loans may decline. Therefore, poor servicing could hinder one of RTC's primary goals—to maximize the return from the sale of failed thrift assets.

Like RTC, Fannie Mae relies on financial institutions to service its mortgages. However, Fannie Mae does review the financial condition and operating performance of its servicers. As a government-sponsored private corporation, Fannie Mae helps support a secondary market for mortgages by purchasing mortgages originated by thrifts, commercial banks, and other lenders. As of December 1991, Fannie Mae relied on about 2,400 financial institutions and mortgage companies to service the mortgages it owns. To protect its investment in the mortgages, Fannie Mae has servicing requirements and standards with which its servicers must comply to keep their eligibility.

Fannie Mae's eligibility criteria require, among other things, that servicers demonstrate a proven ability to service mortgages, employ a staff with adequate experience, have an acceptable net worth, and have quality control and management systems to evaluate and monitor the overall

quality of their loan servicing activities. To determine compliance with its servicing requirements, Fannie Mae annually reviews servicers' audited financial statements and conducts periodic audits of servicers' operations and internal accounting records. In addition, Fannie Mae keeps a database of information about the servicers, including whether they are currently eligible to service its mortgages.

If RTC's inherited servicers were held to Fannie Mae's criteria, 84, or 28 percent, of the 298 servicers for 31 receiverships in Florida in September 1991 would be ineligible to service mortgages and loans. The 298 inherited servicers were servicing 23,000 mortgages and loans valued at $658 million. According to Fannie Mae officials, 21 of the servicers did not meet Fannie Mae's eligibility criteria as of November 1991. In addition, 63 of the servicers were failed thrifts or their affiliated companies, which also would be ineligible under Fannie Mae's criteria. However, under an agreement between RTC and Fannie Mae, failed thrifts controlled by RTC may continue servicing Fannie Mae mortgages until RTC can transfer the servicing rights to an approved Fannie Mae servicer. Table 3 summarizes the status of the 298 RTC servicers under Fannie Mae's servicer eligibility criteria.

Table 3: Status of Inherited Servicers for RTC's September 1991 Florida Receiverships Categorized by Fannie Mae's Eligibility Criteria as of November 1991

Status	Number	Percent
Currently approved	175	59
Currently ineligible	21	7
Temporarily eligible[a]	63	21
Other (not approved)	39	13
Total	**298**	**100**

[a]These servicers did not meet Fannie Mae's criteria but were temporarily eligible under a memorandum of understanding between RTC and Fannie Mae.

Although RTC has adopted many of Fannie Mae's servicing standards for selecting and overseeing the loan servicing contractors it hires, it has not applied these standards to the inherited servicers.

In January 1992, RTC headquarters officials told us that three of the four RTC regional offices planned to hire contractors to oversee the inherited servicers' loan collection and servicing operations. As of March 1992, the regions were drafting contractor solicitations.

RTC Lacks Information to Effectively Oversee Inherited Servicers

RTC needs better information about the inherited servicers before it can begin effective oversight. Currently, RTC does not have a national inventory of these servicers. Although each regional office keeps a list of inherited servicers for the receiverships in its region, the information in many cases is incomplete and inaccurate. As a result, RTC lacks the information it needs to identify all institutions servicing loans under agreements entered into by failed thrifts. In addition, RTC has not been able to determine the total number of inherited servicers or the cumulative number and value of loans they each control.

In many cases, inherited servicers are handling mortgages and loans owned by many thrifts located throughout the country that have gone into receivership at different times. Because it does not yet have information to compile a national inventory of these servicers, RTC cannot determine the total number and value of loans under any one servicer's control. For example, a mortgage company in Texas services 976 loans for Western Region receiverships, 837 loans for Eastern Region receiverships, 407 loans for Southwestern Region receiverships, and 108 loans for North Central Region receiverships. Although this mortgage company handles a relatively small number of loans in each region, it services over 2,300 loans nationally. A consolidated national list of inherited servicers is needed to avoid duplicating oversight efforts by field offices that use the same servicers.

RTC officials also told us they will compile an inventory of inherited servicers when a contractor completes the computer system that will automate asset accounting functions. The computer system, called the Control Totals Module, was being tested as of January 1992, but it is not expected to be fully operational until May 1992.

Conclusions

The lack of oversight of inherited servicers could jeopardize RTC's recovery of asset values by decreasing loan collections and reducing the market value of loan portfolios. Although these servicers handle 33 percent of the mortgages and loans held by thrifts in receivership, RTC is not adequately monitoring their activities or evaluating their performance. Without periodically verifying the accuracy of the loan collections and balances reported by the servicers, RTC cannot ensure that all funds collected from borrowers on its behalf by servicers are properly accounted for and remitted when they are due.

Also, without evaluating servicer performance, RTC cannot identify and take action against servicers that are not performing satisfactorily. Under Fannie Mae's mortgage servicer eligibility criteria, 84, or 28 percent, of 298 RTC inherited servicers of Florida receiverships may not be capable of maintaining the value of RTC's mortgages and loans. However, before it can begin to effectively oversee all of its inherited servicers, RTC will need to compile a reliable national inventory of the institutions providing loan servicing.

Recommendations

To improve the oversight of inherited loan servicers, we recommend that you

- move quickly to compile a national inventory of inherited loan servicers and
- ensure that RTC has policies and procedures in place to monitor and periodically evaluate the servicers' loan collection activities, financial condition, and overall performance.

Agency Comments

We discussed the contents of this report with RTC headquarters officials responsible for loan management and asset operations. They generally agreed with our findings. Their comments have been incorporated into this report where appropriate.

Since RTC was created as a mixed-ownership government corporation, it is not required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs, House Committee on Government Operations, or the House and Senate Committees on Appropriations. However, we would appreciate receiving such a statement within 60 days of the date of this letter to assist our follow-up actions and allow us to keep the appropriate congressional committees informed of RTC activities.

We will provide copies of this report to interested congressional committees, agencies, and the public.

This report was prepared under the direction of Ronald L. King, Assistant Director, Federal Management Issues. Other major contributors are listed in the appendix. Please contact me on (202) 736-0479 if you or your staff have any questions concerning this report.

Sincerely yours,

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